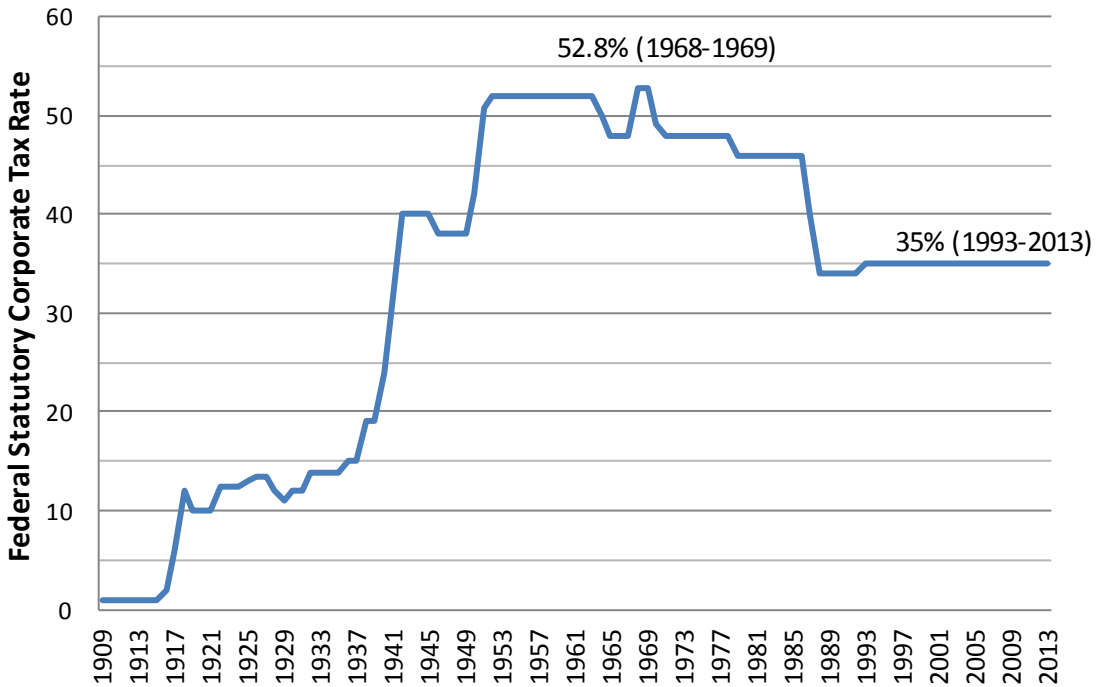


APPENDIX B. FEDERAL STATUTORY CORPORATE TAX RATES, 1909–2013

- The initial corporate income tax in 1909 (enacted as an excise tax on corporate income) imposed a 1 percent tax on corporate income in excess of \$5,000.
- The top tax rate ranged from 10 percent to 19 percent between 1918 and 1939.
- The top corporate rate increased to 40 percent during World War II.
- The maximum tax rate reached 52.8 percent in 1968 and 1969, comprised of a 48 percent regular tax and a 10 percent surtax.
- The top corporate tax rate was reduced by the 1986 tax reform act, with the top rate reduced over two years from 46 percent to 34 percent.
- In 1993, the corporate tax rate was increased to 35 percent, where it remains.

Exhibit 17. Top Federal Statutory Corporate Tax Rate, 1909–2013



Source: IRS Statistics of Income.

APPENDIX C. MAJOR CORPORATE TAX DEVELOPMENTS, 1909–2012

Congress taxes corporate income

- 1909: Federal excise tax imposed on corporations based on income; tax imposed on worldwide income with a deduction for foreign taxes
- 1913: Federal income tax enacted after ratification of 16th Amendment; new law incorporates existing corporate tax, with top rate of 1 percent

Tax rate gradually rises to 52 percent

- 1918: Top rate of 12 percent; allows foreign tax credit (FTC) in place of a deduction for foreign taxes
- 1919: Top rate reduced to 10 percent
- 1922: Top rate of 12.5 percent
- 1936: Top rate of 15 percent
- 1938: Top rate of 19 percent
- 1939: Enactment of Internal Revenue Code of 1939 — restates and revises existing tax law
- 1940: Top rate of 24 percent
- 1941: Top rate of 31 percent
- 1942: Top rate of 40 percent
- 1946: Top rate of 38 percent
- 1950: Top rate of 42 percent
- 1952: Top rate of 52 percent

Developments from 1954 Code until Tax Reform Act of 1986

- 1954: Enactment of Internal Revenue Code of 1954 — restates and revises existing tax law; enacts current deductibility of research and experimental expenditures
- 1962: Revenue Act of 1962 — enacts subpart F limits on deferral, investment tax credit (ITC)
- 1964: Revenue Act of 1964 — top rate of 50 percent
- 1965: Top rate of 48 percent (surcharges applied in 1968–70)
- 1969: Tax Reform Act of 1969 — repeals ITC
- 1971: ITC restored; Domestic International Sales Corporation (DISC) provisions enacted
- 1976: Tax Reform Act of 1976 — extends ITC; expands net operating loss carryover; modifies FTC, DISC, other international tax rules
- 1979: Top rate of 46 percent (under Revenue Act of 1978); ITC permanently extended
- 1981: Economic Recovery Tax Act of 1981 — adopts new Accelerated Cost Recovery System; enacts research tax credit
- 1982: Tax Equity and Fiscal Responsibility Act of 1982 — limits certain corporate tax incentives
- 1984: Deficit Reduction Act of 1984 — enacts Foreign Sales Corporation (FSC) provisions; postpones certain tax reductions to reduce deficit

Tax Reform Act of 1986 reduces corporate rate

- 1986: Tax Reform Act of 1986 — revises and restates existing tax law as the Internal Revenue Code of 1986; enacts modified Accelerated Cost Recovery System; repeals ITC; enacts phased reduction in corporate tax rate for 1987–88; enacts corporate alternative minimum tax; makes extensive changes to international tax rules
- 1987: Top rate of 40 percent
- 1988: Top rate of 34 percent

Rate increase, other developments

- 1993: Top rate of 35 percent; section 197 amortization of goodwill and section 162(m) compensation deduction limitation enacted
- 2000: FSC regime repealed; Extraterritorial Income (ETI) regime enacted
- 2004: ETI regime repealed; section 199 domestic production activities deduction and section 965 temporary foreign earnings repatriation enacted

APPENDIX D. U.S. EMPLOYMENT BY CORPORATIONS AND OTHER BUSINESSES

Business activity is conducted through different legal forms of organization, including corporations, partnerships and sole proprietorships, for various business and tax reasons.

For tax purposes, only business income of so-called C corporations (named after Subchapter C of the tax code) is subject to the corporate income tax. For the most part, businesses seeking to raise capital in publicly traded markets are required to be taxed under the corporate income tax as C corporations. Dividend distributions of corporate earnings from C corporations to individual shareholders are subject to a second level of tax under the individual income tax system when received by the shareholder.

In contrast business income of S corporations (named after Subchapter S of the tax code), partnerships, limited liability corporations and sole proprietorships is attributed directly to their owners and is taxed under the individual income tax system rather than at the entity level.

In 2009, private-sector businesses employed 97.8 million full-time and part-time employees and had total payrolls of \$4.2 trillion.¹⁰⁴ C corporations employed 53.6 million workers and had payrolls of \$2.6 trillion, accounting for 55 percent of business employment and 62 percent of business payrolls (**Exhibit 18**).

Exhibit 18. Employment by Businesses, 2009

Business	Employees (millions)	Percentage of total	Payroll (\$ billions)	Percentage of total
C corporations	53.6	55%	2,627.0	62%
S corporations	27.9	29%	991.9	24%
Partnerships	11.5	12%	457.2	11%
Sole proprietorships	4.8	5%	136.9	3%
TOTAL	97.8	100%	4,213.0	100%

Notes: Employee counts and payroll are of paid employees; proprietors and partners are excluded. Business employment excludes nonprofit and government-sector employment. Percentages may not total 100 due to rounding.

Source: U.S. Census Bureau, U.S. Department of Commerce, Statistics of U.S. Businesses.

Large and small businesses

Large firms, defined as those with 500 or more employees, employed 50 percent of all workers in businesses and accounted for 55 percent of business payrolls in 2009.¹⁰⁵ Among C corporations, large firms employed 38.2 million workers and had payrolls of \$1.9 trillion in 2009.

Both large and small business enterprises play an important role in the economy. One survey of large American companies with international operations finds that nearly one-quarter of all of their domestic business purchases are from U.S. small businesses, accounting for \$1.52 trillion in sales by U.S. small businesses in 2010.¹⁰⁶

Recent research has identified new businesses, which typically start as small businesses, as playing a disproportionate role in contributing to job growth.¹⁰⁷ New businesses may be created to develop new ideas and technologies, and their success leads to rapid growth. However, when one examines businesses of the same age, this research finds no evidence that small firms create jobs at a faster rate than large firms. Instead, it finds that net job creation is roughly in proportion to the amount of employment in each size class of firms.

APPENDIX E. PROFILE OF AMERICAN COMPANIES WITH INTERNATIONAL OPERATIONS

American parent companies with international operations employed 22.8 million workers in the United States in 2010, the latest year for which preliminary data are available.¹⁰⁸ U.S. employment by these companies accounted for more than two-thirds of the worldwide employment of their combined U.S. and majority-owned foreign operations.

The average annual compensation paid in 2010 by American parent companies to their American workers was \$70,700 compared with \$52,900 for U.S. businesses without foreign operations.¹⁰⁹

American companies with international business operations typically are large firms with 500 or more employees. Of the 2,347 U.S. multinational parent companies in 2009, nearly 75 percent had 500 or more employees. These large firms employed 99 percent of American workers who are employed by U.S. multinational corporations.¹¹⁰

As with their significant employment base in the United States, American companies with international operations conduct most of their activity in the United States. More than 75 percent of the compensation paid by these companies to employees is in the United States, and more than two-thirds of the value added from the worldwide activities of these companies arises in the United States.¹¹¹ American parent companies undertook \$438 billion of capital expenditures in plant and equipment in the United States in 2010, representing more than 70 percent of their worldwide capital investment.¹¹²

U.S. parent companies with foreign affiliates directly accounted for 48 percent of all U.S. exports in 2010.¹¹³

Research has shown that increased sales by foreign affiliates of U.S. parent companies are typically associated with greater U.S. employment, greater U.S. investment, and increased exports of goods and services from the United States by the U.S. parent company.¹¹⁴ Findings of one study suggest that an average of 134 U.S. jobs are created in the parent company's U.S. operations for every 100 jobs added abroad in its foreign affiliates.¹¹⁵

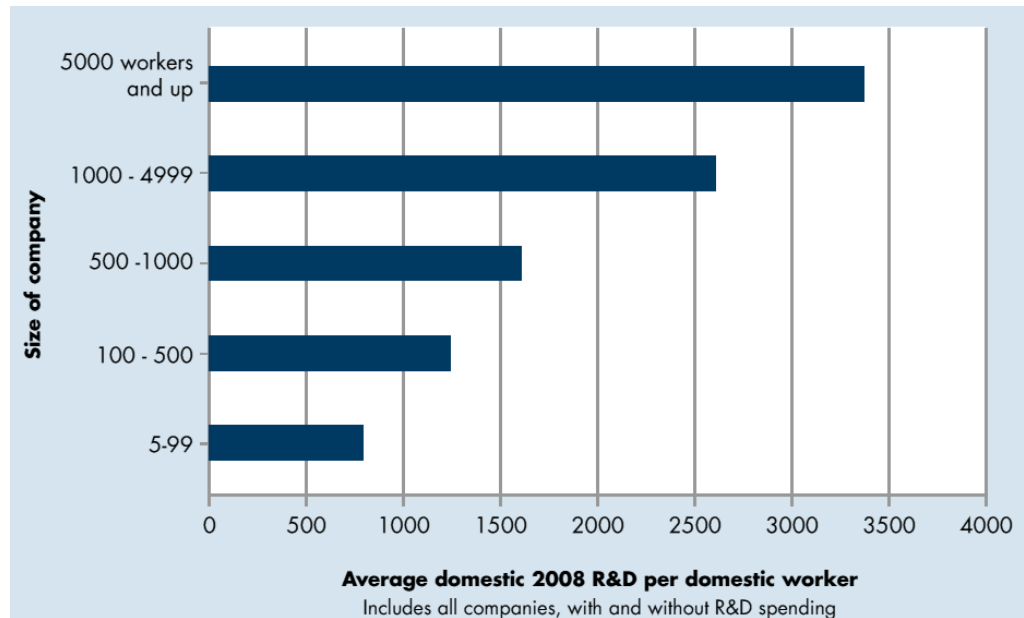
Research and development (R&D) and productivity of American parent companies

R&D expenditures by American parent companies in the United States were \$213 billion in 2010 and represented 84 percent of their worldwide R&D expenditures.¹¹⁶ In 2009, R&D by American parent companies accounted for 73.4 percent of all research undertaken by American companies in the United States.¹¹⁷ Sales to foreign markets help support domestic R&D by providing a larger base of sales over which to spread the costs of developing new products and processes.

A study by Michael Mandel of the Progressive Policy Institute, based on National Science Foundation data, finds that large firms on average undertake significantly more R&D per employee than small firms.¹¹⁸ This study reports that companies employing more than 5,000

workers had research expenses averaging \$3,368 per worker in 2008. Per-worker R&D expense declined for all smaller sized firms, with the smallest companies — those employing from 5 to 99 workers — spending an average of \$793 per worker on R&D, less than a quarter as much (**Exhibit 19**). In addition, the study finds that companies spending more on research achieve significantly more innovations.

Exhibit 19. Average R&D per Employee Increases with Company Size



Source: Michael Mandel, *Scale and Innovation in Today's Economy*, Progressive Policy Institute (December 2011).

A study by Federal Reserve Board economists finds that American companies with international operations are responsible for significant increases in U.S. labor productivity. The study finds that these companies were responsible for more than three-fourths of the increase in labor productivity in the U.S. corporate sector between 1977 and 2000 and all of the labor productivity growth in the U.S. corporate sector in the late 1990s.¹¹⁹

Research by the Bureau of Economic Analysis finds that American manufacturing companies with foreign operations were 16 percent more productive than companies that operated only in the United States.¹²⁰ Further, this productivity advantage increases with the global scope of a company's operations. In 2008, American companies operating in 10 or more countries had 54 percent greater value added per employee than those companies operating in just one foreign country and 21 percent greater value added per employee than companies that operated in two to nine foreign countries.¹²¹ Higher worker productivity in turn is the key determinant of higher wages and a higher standard of living for American workers.

Given the importance of R&D activities in fostering technological advancements and productivity gains, it is important that tax policy not diminish the ability of large companies to compete successfully globally. Worldwide operations of these companies provide the scale that allows these companies to invest in risky R&D activities.

APPENDIX F. GLOSSARY OF TAX TERMS

The language of tax experts can be confusing, even to experienced audiences. To help decisionmakers understand the complex issues of taxation, the Business Roundtable has compiled this glossary that defines some of the most frequently used tax terms.

- **Accelerated Depreciation:** Depreciation method under which tax deductions for depreciation are taken more rapidly than the decline in economic value of an asset. (Also see “*Depreciation*,” “*Bonus Depreciation*” and “*Expensing*.”)
- **Active Income:** Income earned by a corporation through the active conduct of a trade or business, in contrast to income earned from a passive investment activity.
- **Active Financing Income Rule:** U.S. tax rules generally defer taxation of income from an active foreign business until that income is remitted to the U.S. parent. Under subpart F rules, interest and related income of a foreign subsidiary generally are subject to current taxation without benefit of deferral. These rules historically have aimed at requiring current taxation of income that is *passive* or easily moveable, although some forms of *active* income also are subject to these rules. The active financing income rule in present law is a temporary measure to permit deferral of certain types of income derived from the *active* conduct of a banking, finance or insurance business. This provision, most recently extended in January 2013, expires for taxable years beginning after December 31, 2013.
- **Advance Pricing Agreement (APA):** A binding agreement between a taxpayer and a taxing authority (unilateral) or two taxing authorities (bilateral) on the taxpayer’s transfer pricing method for specific transactions.
- **Affiliates:** Entities that are related through a common ownership interest. This relationship can occur between a parent corporation and a subsidiary or through common ownership, such as brother-sister corporations.
- **Allocation:** The process of assigning income or expenses to a specific jurisdiction or categories of income and/or expenses based on their association with that jurisdiction or category. Allocation differs from apportionment as the former generally involves identifying how specific items of income or expense should be assigned to a jurisdiction or category.
- **Alternative Minimum Tax, Corporate:** Federal tax rules require companies to compute tax liability under the regular rules of the income tax system and then a second time under an alternative calculation that disallows many deductions, exemptions and business tax credits but applies a lower statutory rate of tax (20 percent). Corporations are required to pay the larger of their regular tax liability or the alternative tax amount.
- **Amortization:** The systematic, straight-line reduction of the basis of an intangible asset, in the form of a deduction, over the useful life of the asset. As in the case of depreciating

tangible assets, U.S. tax law provides guidance for the length of the useful life for different types of intangible assets.

- **Apportionment:** The process of assigning income or expenses among jurisdictions or categories, usually through use of a formula.
- **Arm's-Length Standard:** Under current law, transactions between a U.S. parent company and its foreign subsidiaries are required to use the same prices that the parent company and its foreign subsidiaries would use with unrelated companies. This principle of determining internal transfer prices using the same terms as would apply with unrelated companies is also known as the arm's-length standard. It allows for agreement by countries with potentially conflicting interests to use a well-accepted principle for determining the source of income in cross-border transactions between related parties.
- **Average Tax Rate:** The percentage of a taxpayer's income used to pay tax. The rate is determined by dividing the tax liability of the taxpayer by its taxable income.
- **Base Broadening:** Changes to tax rules that expand the tax base. When discussed in the context of income tax reform, such proposed changes typically increase the measure of taxable income by repealing or limiting deductions or exclusions from income or by repealing or limiting tax credits that reduce income tax liability.
- **Bonus Depreciation:** A temporary provision providing partial or full expensing of an asset in the year the asset is placed in service. In years the provision has been in effect, the amount of expensing permitted in the first year has been 30, 50 or 100 percent, depending on the asset's placed-in-service date. The basis of each qualifying asset is adjusted by the amount of bonus depreciation taken before applying standard depreciation rules. Bonus depreciation of 50 percent is permitted for certain assets placed in service in 2012 and 2013.
- **C Corporation:** A corporation that is subject to tax at the entity level under Subchapter C of the Internal Revenue Code.
- **CFC Look-Through Rule:** In May 2006, Congress enacted a temporary "look-through" exception for subpart F with respect to payments of dividends, interest, rents and royalties between related controlled foreign corporations (CFCs). The rule provides that such payments will not give rise to subpart F income (thereby permitting deferral) to the extent the payments come from active, nonsubpart F earnings of the payer CFC. In effect, the provision "looks through" the form of payment to the underlying source of income. The provision was adopted to permit foreign subsidiaries of U.S. companies to redeploy active foreign earnings in a manner similar to that permitted by most U.S. trading partners. This exception from subpart F, extended in January 2013, expires for taxable years beginning after December 31, 2013.
- **"Check-the-Box" Election:** An election that allows an American company (or individual) to choose how an entity it owns, either domestic or foreign, will be treated

for U.S. tax purposes. Before the check-the-box election was created, entities were determined to be corporations or pass-through entities based on detailed review of their characteristics.

- **Combined Corporate Tax Rate:** The tax rate of a corporation that includes the federal income tax rate as well as any state and local income tax rates, reduced by the benefit of any deduction allowable at the federal level for the state and local taxes. The average combined corporate tax rate for U.S. corporations in 2012 is 39.1 percent: 35 percent federal rate plus an average state and local rate of 4.1 percent net of deductibility at the federal level (6.4 percent before deductibility at the federal level).
- **Consumption Tax:** A tax levied on the value of a good or service to the ultimate consumer. Types of consumption taxes include sales tax, use tax, value added tax (VAT), and goods and services tax (GST). Sales and use taxes are assessed on the sale or use of a good or service, whereas a VAT or GST is levied at each stage of the supply chain with the total cost being borne by the ultimate consumer.
- **Controlled Foreign Corporation (CFC):** A foreign corporation in which more than 50 percent of the voting power or value of the stock is held by U.S. shareholders. Only a U.S. shareholder that owns 10 percent or more of the stock of the foreign corporation is included in this determination. Subpart F rules apply to foreign subsidiaries that are CFCs.
- **Defer Deduction of Interest Expense Related to Deferred Income:** A proposal in the President's FY 2014 budget that would require taxpayers to defer the deduction of their interest expense that is properly allocated and apportioned to foreign source income that is not taxable in the current year. The deferred interest expense would become deductible when deferred foreign earnings are repatriated to the United States and therefore become subject to taxation.
- **Deferral:** The United States defers collecting taxes on earnings of the foreign subsidiaries of U.S.-based corporations until those earnings actually are paid to the U.S. parent, with some exceptions (see "*Subpart F*"). Most frequently, repatriated foreign earnings are paid as a cash dividend to the U.S. parent company. This method of taxation mirrors the tax treatment of individual shareholders in a domestic corporation, who are not taxed on the earnings of the corporation until they receive a distribution from the corporation. All OECD member countries and other developed nations that tax the worldwide earnings of their globally operating corporations permit some form of deferral or otherwise exempt such earnings from domestic taxation.
- **Depreciation:** The systematic reduction of the basis of fixed assets, in the form of a deduction, for the basic wear and tear and loss of value over the useful life of the assets. U.S. tax rules provide specifications for the useful life of many types of assets.
- **Disregarded Entity:** An entity that is 100 percent owned by one owner and is not considered separate from its owner for tax purposes. The owner may make a check-the-box election to treat a wholly owned entity as disregarded. All assets, liabilities, income, deductions, etc. of the disregarded subsidiary are included with those of the owner.

- **Dividend:** A taxable distribution, for which a corporation has enough earnings and profits to cover the payment, to the shareholders of the corporation. Although dividends are taxable income to the receiving shareholders, they are considered reductions in retained earnings of the distributing company and therefore are not deductible by the payer.
- **Dividends Received Deduction (DRD):** A deduction a corporation may take on a percentage of certain dividends received from another corporation. Dividends that qualify generally must come from a domestic corporation. The percentage of the DRD generally is 70 percent of the dividend received. However, the DRD is 100 percent for dividends received from another member of same affiliated group of corporations. A temporary provision enacted in 2004 provided for an 85 percent DRD for dividends received from a controlled foreign corporation (see “*Homeland Investment Act*”).
- **Domestic Production Activities Deduction:** A deduction of 9 percent (previously 3 percent in 2005 and 2006 and 6 percent in 2007, 2008 and 2009) of U.S. taxable income or qualified production activities income, whichever is less, for domestic producers of goods. The deduction is limited to 50 percent of the wages the taxpayer paid to employees, as reported on W-2s for the year. The deduction relates to taxable income earned for goods produced in the United States. This deduction is often referred to as the “Section 199 deduction” for the Internal Revenue Code section that provides the deduction.
 - *Domestic Production Gross Receipts (DPGR)* are the gross receipts associated with the sale, exchange, lease, rental or license of qualifying production property that has been manufactured, produced, grown or extracted completely or significantly within the United States by the taxpayer; gross receipts from the taxpayer’s domestic production of qualified films, electricity, natural gas or potable water; and gross receipts from construction of real property in the United States and related engineering or architectural services on such property performed in the United States.
 - *Qualified Production Activities Income (QPAI)* is the measure of income for purposes of the domestic production activities deduction, equal to the amount of DPGR that are greater than the cost of goods sold and other deductions properly allocated to such receipts.
 - *Qualified Production Property (QPP)* is property that is considered tangible personal property, computer software or a sound recording.
- **Double Taxation:** The taxing of income at two levels. Domestically, double taxation occurs when a corporation is taxed on its earnings and the earnings are subject to tax again (as a dividend) when they are distributed to the corporation’s shareholders. Internationally, double taxation occurs when any item of income is taxed in the foreign country where it was earned and then taxed again by the taxpayer’s home country due to a limitation or denial of credits for the taxes previously paid to the foreign country for that income. Jurisdictional double taxation refers to the system of taxation under which foreign income is subject to tax once in the source country where the income was earned and the income is subject to a second level of additional tax in the home country

of the taxpayer, even after receiving a credit for foreign taxes paid. Jurisdictional double taxation arises under worldwide systems of taxation, such as in the United States.

- **Earnings and Profits (E&P):** A tax accounting term describing a measure of income or surplus used to determine if a corporation has enough economic means to cover distributions. E&P is calculated through adjustments to taxable income. Current E&P is the E&P from the current tax year and is accounted for as of the end of the year, before consideration of any distributions made during the year. Accumulated E&P is the amount of E&P from prior years that has not been reduced previously through distributions. Ordering rules require distributions to first reduce current E&P and then accumulated E&P. If more is distributed in a year than total E&P of the corporation, shareholders receive a return of capital up to their basis. Any remaining distribution is treated as a capital gain or loss.
- **Earnings Stripping Rules:** Current U.S. tax rules defer deductions for interest expense associated with related-party debt if incurred by a thinly capitalized U.S. subsidiary of a foreign corporation. For purposes of these rules, debt of such a U.S. corporation guaranteed by its foreign owner is considered related-party debt.
- **Effective Average Tax Rate:** Sometimes used as a synonym for effective tax rate but used by economists to evaluate the rate of tax paid on a highly profitable investment. It provides a measure of the disincentive effects of a tax system for undertaking such investments. (Contrast with “Average Tax Rate,” “Effective Tax Rate” and “Marginal Effective Tax Rate.”)
- **Effective Marginal Tax Rate:** See “Marginal Effective Tax Rate.”
- **Effective Tax Rate:** Effective tax rates typically measure the average rate of tax relative to a measure of income (sometimes other than taxable income). For example, “book” effective tax rates measure tax payments relative to financial statement income. (Somewhat different concepts are “Effective Average Tax Rate” and “Marginal Effective Tax Rate.”)
- **Excess Returns Proposal:** To reduce the incentive for taxpayers to engage in certain related-party transactions, the Obama Administration has proposed expanding subpart F income to include a new category of “excess” income attributable to intangibles transferred from the United States to low-taxed controlled foreign corporations (CFCs). Under the President’s FY 2014 budget proposal, if a U.S. person transfers (directly or indirectly) an intangible from the United States to a related CFC (a “covered intangible”), certain excess income from transactions connected with, or benefiting from, the covered intangible is treated as subpart F income if the income is subject to a foreign effective tax rate of less than 15 percent. “Excess intangible income” is defined as the excess of gross income from transactions connected with, or benefiting from, such intangible over the costs (excluding interest and taxes) properly allocated and apportioned to this income, increased by a percentage mark-up.
- **Exemption System:** See “Territorial Tax System.”

- **Expensing:** A term used to describe when a taxpayer deducts the full cost of property in the year it is placed in service, rather than capitalizing the asset and deducting its value over time, as with depreciation. The rules under Section 179 of the Internal Revenue Code allow expensing of qualified property. Bonus depreciation rules for assets placed in service for certain years are eligible for partial or full expensing of qualifying property.
- **Extraterritorial Income (ETI):** Gross income earned by the taxpayer from foreign trading gross receipts on U.S. exports. Under prior law, ETI could be excluded from gross receipts when determining taxable income of a U.S. taxpayer. ETI was enacted to replace the Foreign Sales Corporation regime. The World Trade Organization (WTO) deemed the ETI rules to be an export subsidy, which is illegal under international trade laws. ETI rules were repealed in the American Jobs Creation Act of 2004 and replaced with the domestic production activities deduction.
- **First-In, First-Out (FIFO):** A method used to value inventory on hand at the end of a tax year. Under FIFO, items are sold in the same order they were purchased or manufactured. As a result, stock on hand at the end of the year consists of the latest goods purchased or produced. FIFO matches current sales with the cost of the earliest acquired or manufactured inventory.
- **Foreign Base Company Income (FBCI):** A type of foreign income that is subject to current U.S. taxation under subpart F rules whether or not distributed to U.S. shareholders. The four categories of FBCI are:
 - *Foreign Personal Holding Company Income* is income that consists of dividends, interest, royalties, rents and other kinds of investment income;
 - *Foreign Base Company Sales Income* is income that is derived from the purchase and sale of property involving a related party where the property originates outside the country in which the controlled foreign corporation (CFC) is organized and is sold for use outside such foreign country;
 - *Foreign Base Company Services Income* is services income arising on behalf of a related person outside the country in which the CFC is organized; and
 - *Foreign Base Company Oil Related Income* is income arising from the sale of oil and gas products except where the income is earned in the country in which it is extracted.
- **Foreign Sales Corporation (FSC):** A corporation formed under the laws of a foreign country or U.S. possession (other than Puerto Rico), meeting certain requirements, that exports U.S. goods. Under prior law, an FSC could treat a portion of its foreign trade income as tax exempt, and the remaining income was eligible for a generous dividends received deduction. The World Trade Organization declared the FSC system to be illegal, and U.S. tax laws permitting the entities were repealed in 2000, with the exception of transition rules.
- **Foreign Tax Credit (FTC):** To avoid double taxation of foreign income, the United States provides a credit against U.S. income tax for income tax paid to the host country.

Without this credit, significant double taxation would make foreign investments noncompetitive for U.S.-based international companies. The FTC is subject to various limitations to ensure that a U.S. company pays at least as much tax on its worldwide income as it would pay on the same income earned at home.

- **Foreign Tax Credit (FTC) Pooling:** A proposal included in the Obama Administration's FY 2014 budget for restricting the amount of FTC that could be claimed against U.S. tax on foreign income. Under current U.S. tax law, foreign income taxes deemed paid by a controlled foreign corporation (CFC) are determined by taking the post-1986 foreign income taxes of the distributing CFC and multiplying that amount by the dividend paid over the post-1986 undistributed earnings and profits of the distributing CFC. The FTC pooling proposal would restrict a U.S.-based multinational group's deemed-paid FTCs to the average rate of total foreign tax paid on total foreign earnings, including CFCs not remitting foreign income. The proposal effectively treats all of a taxpayer's CFCs as a single CFC for FTC purposes.
- **G-8:** Also known as the Group of Eight, includes Canada, France, Germany, Italy, Japan, Russia, the United Kingdom and the United States.
- **Goods and Services Tax:** See "*Value Added Tax.*"
- **Homeland Investment Act:** Part of the American Jobs Creation Act of 2004 that provided for a one-time 85 percent dividends received deduction (DRD) on distributions remitted to U.S. corporations from controlled foreign corporations. The dividend eligible for the DRD was limited to an amount that was in excess of average repatriated earnings from prior tax years. Calendar year taxpayers had to receive the eligible dividend by December 31, 2005, to benefit from the DRD.
- **Incidence of Tax:** The economic burden of a tax. The person bearing the incidence of the tax can be different from the person legally responsible for the tax payment.
- **Intangible Property:** Property that cannot be touched, such as a patent, copyright, noncompete agreement or goodwill. Intangible property with a limited life may be amortized, rather than depreciated, over time.
- **Intellectual Property:** Property that is generally intangible in nature that is protected by copyrights, patents, trademarks, trade names, etc.
- **Investment Tax Credit:** A credit for investment in certain business or income-producing depreciable property for rehabilitation, energy or therapeutic discovery purposes that is part of the general business credit. Prior to 1986, a comprehensive investment tax credit was available for general tangible personal property, subject to limitations, placed in service during the tax year.
- **Last-In, First-Out (LIFO):** Method used for valuating inventory on hand at the end of the year that treats the items most recently produced or purchased by a taxpayer as sold first. Any goods purchased or produced during a year that remain on hand at the end of that year create a "layer." A layer is depleted only when all goods from the current year are considered sold and any layers that had since been created have already been depleted. The objective of LIFO is to match current sales with current replacement

costs. To use LIFO for tax purposes, taxpayers must also use LIFO for financial statement purposes. This stipulation is known as the LIFO conformity requirement.

- **Limited Liability Company (LLC):** An entity in which the liability of its members (owners) is limited to their investment in the entity. The default tax treatment of a multiple-member LLC is as a partnership. Single- and multiple-member LLCs may elect to be taxed as a corporation. A single-member LLC that does not elect to be treated as a corporation is disregarded for tax purposes.
- **“Lockout” Effect (Repatriation):** The disincentive for a U.S. company to remit earnings from a foreign subsidiary for reinvestment in the United States due to the additional layer of tax that would be required under the U.S. worldwide tax system, compared to the ability to repatriate funds with little or no additional tax under the territorial tax systems of most other OECD countries.
- **Marginal Effective Tax Rate:** Used by economists to evaluate the rate of tax paid on an investment on which the after-tax profits are just sufficient to cover the investor’s opportunity cost of capital. Also referred to as the “effective marginal tax rate.” The marginal effective tax rate provides a measure of the disincentive to undertake additional new investment. (Contrast with “Effective Average Tax Rate.”)
- **Marginal Tax Rate:** The tax rate at which a taxpayer’s last dollar of income is taxed.
- **Partnership:** An association of two or more persons (or entities) engaged in a business for profit. Under U.S. law, partnerships are not taxable at the entity level; instead, items of income, deduction, gain and loss flow through to the tax returns of the ultimate owners.
 - *General Partnership* is a partnership in which all partners have joint and several liability for debts.
 - *Limited Partnership* is a partnership with general and limited partners. General partners manage the business and share full responsibility for debts of the company. Limited partners do not participate in managing the business, and their liability is limited to their investment in the company.
- **Passive Income:** Income earned in the form of interest, dividends and similar investment income through investment activities of the taxpayer (as opposed to income earned from the taxpayer’s active conduct of a trade or business).
- **Pass-Through Entity:** An entity that is not itself taxed but instead allocates its items of income, deduction, gain and loss to its owners, who will include such items with their income to be taxed. Partnerships, limited liability companies and S corporations are all generally considered pass-through entities.
- **Patent Box (Innovation Box):** A tax regime adopted by a number of countries over the past decade that applies a reduced rate of corporate tax to income resulting from qualifying intellectual property (IP). Since 2001, seven European Union countries — Belgium, France, Hungary, Luxembourg, Netherlands, Spain and the United Kingdom — have adopted patent boxes that tax qualifying IP income at a reduced rate ranging

between 5 percent and 15 percent. The U.K. patent box, set to begin in 2013, applies a 10 percent tax rate to qualifying income.

- **Repatriated Earnings:** Income earned by a foreign subsidiary that has been brought back to a taxpayer's home country, generally in the form of a dividend. U.S. tax is usually assessed when foreign income is repatriated.
- **Revenue Neutral:** Changes to the tax system that result in no change in total revenue collections by the government. Revenue-reducing changes are exactly offset by other changes than increase tax revenue.
- **S Corporation:** A domestic small business corporation that for U.S. tax purposes has elected to have items of income, deduction, gain and loss flow through to shareholders. These items are apportioned on a per-share, per-day basis. To be an S corporation, businesses must meet and maintain certain requirements, including: (1) there are no more than 100 shareholders (attribution rules apply to determine one shareholder), (2) shareholders may only be individuals (and certain estates or trusts thereof), (3) shareholders may not be non-U.S. persons, and (4) the company may only have one class of stock.
- **Single-Member LLC:** A limited liability company owned 100 percent by one member. Under U.S. tax law, the default treatment of a single-member LLC is as a disregarded entity, or not separate from its owner. A single-member LLC may elect to be taxed as a corporation separate from its owner.
- **Sole Proprietorship:** An unincorporated business owned by one individual, who is liable for all debts of the company. For U.S. tax purposes, all taxable profits and losses are not considered separate of the owner, who is liable for self-employment tax on income earned through the sole proprietorship.
- **Source Rules:** Rules used to allocate worldwide income, expenses and taxes into U.S. amounts and foreign amounts. In general, income is sourced to the place where the activity occurred that gave rise to the income, netted against directly related expenses.
- **Statutory Tax Rate:** The rate, as provided by law, that a taxpayer applies to net taxable income to determine tax liability. The top U.S. federal statutory corporate income tax rate is 35 percent.
- **Subpart F:** Ten percent U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC whether or not such income is actually distributed to the U.S. parent (i.e., without the advantage of deferral). These rules historically have aimed at requiring current taxation of income that is *passive* or easily moveable, although some forms of *active* income are also subject to these rules. Income subject to tax under subpart F includes certain insurance income and foreign base company income (defined previously).

- ***Tax Expenditure:*** Provisions in the Internal Revenue Code that provide taxpayers with favorable treatment relative to an assumed baseline tax system, generally through a special deduction, credit, exclusion, exemption or lower rate.
- ***Tax Information Exchange Agreement (TIEA):*** A treaty between two governments to share tax-related information to reduce tax evasion.
- ***Tax Treaty:*** A formally signed, executed and ratified agreement between two governments negotiated to promote international trade and investment by reducing (or eliminating) the double taxation of income. U.S. tax treaties are negotiated by the Treasury Department subject to approval by the Senate.
- ***Territorial Tax System:*** Under a territorial or “exemption” system, the active foreign earnings of a foreign subsidiary are not subject to tax by the home country when paid as a cash dividend to the parent corporation. In 2012, 28 of the 34 OECD countries, including all G-8 countries other than the United States, followed a territorial or exemption approach, with the remainder following a worldwide approach.
- ***Thin Capitalization Rule:*** Taxpayers with foreign related-party debt that have a high debt-to-equity ratio (i.e., are thinly capitalized) may be disallowed deductions of interest payments related to the excess debt.
- ***Transfer Pricing:*** U.S. tax law requires that taxpayers report income earned on cross-border transactions with related parties by setting appropriate internal prices for these transactions. Transfer pricing is the methodology by which these internal prices are determined. The transfer pricing system is enforced by the Internal Revenue Service through audits, advance pricing agreements and the rule-making process. Foreign governments also enforce and monitor transfer pricing to ensure that the foreign government taxes its proper portion of profits sourced to it.
- ***Value Added Tax (VAT):*** The VAT is the most common form of consumption tax in the world. Like a sales tax, a VAT is imposed on the final consumption of goods and services. Unlike a sales tax, which is collected once on the sale to the end user, a VAT is imposed on the value added at every stage of the supply chain. To avoid a cascading of the tax, each buyer in the supply chain, except the ultimate consumer, recovers the VAT paid through either the credit method or subtraction method. Under the credit method, VAT is collected on sales to other businesses or the ultimate consumer with an offsetting credit for VAT paid on purchases from other businesses. Under the subtraction method, the value added is determined by subtracting deductible pretax purchases from other businesses from pretax gross receipts from sales to other businesses or the ultimate consumer.
- ***Withholding Tax:*** A tax that is collected and paid to a taxing authority by the taxpayer that is the source of the income, rather than the taxpayer that has earned the income. For example, employers generally are required to withhold income tax from compensation paid to their employees. In international taxation, withholding taxes are often imposed on passive income, such as royalties, dividends and interest.

- ***Worldwide Interest Allocation:*** The American Jobs Creation Act of 2004 modified the interest expense allocation rules by providing a one-time election to allocate and apportion third-party interest expense of U.S. members of a worldwide affiliated group to foreign-source income for foreign tax credit limitation purposes in an amount equal to the excess, if any, of (1) the worldwide affiliated group's interest expense multiplied by the ratio of total foreign assets of the group over worldwide assets over (2) third-party interest expense incurred by foreign members of the group that otherwise would be allocated to foreign sources. This worldwide fungibility approach is considered a benefit for U.S. taxpayers with foreign affiliates that incur significant interest expense. This provision was originally effective for tax years beginning after December 31, 2008. The effective date has since been delayed several times; as of 2012, the effective date is for tax years beginning after December 31, 2020.
- ***Worldwide Tax System:*** Under a worldwide system of taxation, all foreign earnings of a domestic corporation are subject to tax in the home country. In practice, countries following a worldwide approach, including the United States, permit deferral on most forms of active foreign earnings until such income is paid to the domestic corporation. Within the 34 countries of the OECD, six countries follow a worldwide approach, with the other 28 countries following a territorial or exemption approach. Worldwide countries in the OECD are Chile, Ireland, Israel, Korea, Mexico and the United States.

Endnotes

¹ Rankings are from the Global Fortune 500 for various years. The 2012 list is available at http://money.cnn.com/magazines/fortune/global500/2012/full_list/.

² Based on the 2012 Global Fortune 500 list available at http://money.cnn.com/magazines/fortune/global500/2012/full_list/.

³ Based on the 1995 Global Fortune 500 list.

⁴ Total U.S. jobs supported include direct employment of U.S. parent companies, indirect jobs through their supply chain, and jobs supported by the spending of their employees and employees of their suppliers.

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⁶ OECD, *Tax Policy Reform and Economic Growth*, 2010, p. 20.

⁷ These studies include a number of studies conducted by OECD economists, including Åsa Johansson, Christopher Heady, Jens Arnold, Bert Brys and Laura Vartia, *Tax and Economic Growth*, OECD Economics Department Working Paper No. 620, July 11, 2008; Jens Arnold, *Do Tax Structures Affect Aggregate Economic Growth? Empirical Evidence from a Panel of OECD Countries*, OECD Economics Department Working Paper No. 643, October 14, 2008; Cyrille Schwellnus and Jens Arnold, *Do Corporate Taxes Reduce Productivity and Investment at the Firm Level? Cross-country Evidence from the Amadeus Dataset*, OECD Economics Department Working Paper No. 641, September 30, 2008; and Laura Vartia, *How Do Taxes Affect Investment and Productivity? An Industry-Level Analysis of OECD Countries*, OECD Economics Department Working Paper No. 656, December 19, 2008. Other studies include Simeon Djankov, Tim Ganser, Caralee McLiesh, Rita Ramalho and Andrei Shleifer, “The Effect of Corporate Taxes on Investment and Entrepreneurship,” *American Economic Journal: Macroeconomics*, July 2010.

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¹³ William C. Randolph, *International Burdens of the Corporate Income Tax*, Congressional Budget Office, August 2006.

¹⁴ William M. Gentry, “A Review of the Evidence on the Incidence of the Corporate Income Tax,” Office of Tax Analysis Paper 101, U.S. Department of the Treasury, December 2007.

¹⁵ Mihir A. Desai, C. Fritz Foley and James R. Hines, Jr., *Labor and Capital Shares of the Corporate Tax Burden: International Evidence*, December 2007.

¹⁶ Wiji Arulampalam, Michael P. Devereux and Giorgia Maffini, *The Direct Incidence of Corporate Income Tax on Wages*, October 2010.

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¹⁸ See Kevin A. Hassett and Aparna Mathur, *Spatial Tax Competition and Domestic Wages*, American Enterprise Institute, December 2010.

¹⁹ See www.hamiltonproject.org/jobs_gap.

²⁰ U.S. Bureau of Economic Analysis, *National Income and Products Accounts*, Table 1.1.5.

²¹ U.S. Bureau of Economic Analysis, *National Income and Products Accounts*, Table 6.16.

²² United Nations Conference on Trade and Development UNCTADStat database.

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²⁴ Homi Kharas, “The Emerging Middle Class in Developing Countries,” OECD Development Centre Working Paper No. 285, 2010.

²⁵ Goldman Sachs, *EM Equity in Two Decades: A Changing Landscape*, Global Economics Paper No: 204, September 8, 2010. These comparisons are based on market exchange rates. Using purchasing power parity exchange rates, the economies of the emerging market countries would be larger than the economies of the industrialized countries at an earlier date.

²⁶ Based on countries of companies in the 2012 Global Fortune 500, available at http://money.cnn.com/magazines/fortune/global500/2012/full_list/. Non-U.S. OECD companies represent 258 of the Global 500 companies, with 240 (93 percent) of these companies being based in territorial OECD countries. The United States has the highest combined statutory corporate tax rate within the OECD.

²⁷ The phaseout of itemized deductions adds 1.2 percent, and the net investment income tax, sometimes referred to as the Medicare contribution tax, adds an additional 3.8 percent tax.

²⁸ For comparison, the maximum individual federal tax rate on self-employment income earned from a pass-through is 44.6 percent in 2013 (comprised of 39.6 percent top individual statutory rate, 1.2 percent phaseout of itemized deduction and 3.8 percent Medicare tax) up from 37.9 percent in 2012 (35 percent top individual statutory rate and 2.9 percent self-employment Medicare tax). Certain pass-through business income is not subject to the Medicare tax.

²⁹ Internal Revenue Service, Statistics of Income, Integrated Business Data. Pass-through entities include sole proprietorships, partnerships and S corporations. Comparisons exclude regulated investment companies and real estate investment trusts. Data include businesses with positive net income and losses.

³⁰ International comparisons of the significance of pass-through businesses are provided in U.S. Department of the Treasury, *Treasury Conference on Business Taxation and Global Competitiveness, Background Paper*, July 23, 2007, pp. 16–17. These data indicate that in 2004, 66 percent of businesses with \$1 million or more in profit were unincorporated in the United States. The country with the next largest share of unincorporated businesses earning \$1 million or more in profit was Mexico, with 27 percent, followed by the United Kingdom, with 26 percent. These figures understate the percentage of large businesses in the United States not subject to corporate income tax, as S corporations — which are taxed on a pass-through basis — were reported as corporations in these data. Additional detail is available in *Survey on the Taxation of Small and Medium-Sized Enterprises*, OECD, September 2007.

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³² World Bank Group, *Paying Taxes 2013: The Global Picture*, 2012, available at www.doingbusiness.org/reports/thematic-reports/paying-taxes.

³³ Duanjie Chen and Jack Mintz, *2012 Annual Global Tax Competitiveness Ranking*, University of Calgary, September 2012.

³⁴ Katarzyna Bilicka and Michael Devereux, *CBT Corporate Tax Ranking 2012*, Oxford University, June 2012.

³⁵ PricewaterhouseCoopers, *Global Effective Tax Rates*, April 14, 2011, available at http://businessroundtable.org/uploads/studies-reports/downloads/Effective_Tax_Rate_Study.pdf.

³⁶ These proposals are summarized in more detail in Appendix A.

³⁷ OECD corporate tax database and country research. Chile’s corporate tax rate has increased from 10 percent to 20 percent since 1988. For OECD countries formed as independent countries after 1988, the current corporate rate is compared to the rate at the time the country was founded. For Hungary, the current corporate tax rate is compared to the rate established in 1989, when Hungary adopted reforms as part of its transition to a market economy.

³⁸ Because state income taxes are deductible against federal taxes, the combined statutory tax rate takes into consideration the after-tax cost of state income taxes.

³⁹ After taxes the investment in other OECD countries yields an average of \$75 compared to slightly less than \$61 in the United States, a difference of 23 percent.

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- ⁴⁰ Martin Sullivan notes that this is true even with expensing, the most accelerated form of depreciation. “With expensing, low-profit investments are favored over high-profit investments. Therefore when a government chooses expensing over lower rates, it is adopting a policy that attracts and retains low-profit investment at the expense of high-profit investment.” Martin A. Sullivan, “Beyond the Conventional Wisdom: Rate Cuts Beat Expensing,” *Tax Notes*, January 28, 2008, p. 463.
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- ⁴⁴ International Monetary Fund, Fiscal Affairs Department, “Debt Bias and Other Distortions: Crisis-Related Issues in Tax Policy,” June 12, 2009.
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- ⁶² Lisa Alejandro, et al., “U.S. Multinational Service Companies: Effects of Affiliate Activity on U.S. Employment,” U.S. International Trade Commission, August 2011.
- ⁶³ Matthew J. Slaughter, *American Companies and Global Supply Networks*, January 2013, pp. 44–46.

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